PODCAST TRANSCRIPTION SESSION NO. 139-MARLA BLOW

Welcome to the Lend Academy Podcast, Episode No. 139. This is your host, Peter Renton, Founder of Lend Academy and Co-Founder of LendIt,

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Today's episode is sponsored by LendIt USA 2018, the world's leading event in financial services innovation. It's going to be happening April 9th through 11th, 2018 at Moscone West in San Francisco. We are going to be covering blockchain, digital banking and of course, online lending, as well as other areas of fintech. There will be over 5,000 attendees, over 250 sponsors and registration is now open. Just go to lendit.com/usa to register.

Peter Renton: Today on the show, I am delighted to welcome Marla Blow, she is the CEO and Founder of FS Card. Now we wanted to get Marla on the show because FS Card is a fascinating story and Marla has undertaken something that is somewhat unusual and certainly very challenging. She decided to create a credit card company and not just any credit card company, but one that is focused on the subprime community, the underserved community.

So I wanted to talk about why she wanted to do this, her experience in getting the company set up. They've been in business now for a couple of years so I wanted to get a little bit of sense of how they're doing and get a sense of how they're able to offer a credit card, this is an unsecured credit card, to those customers that most of the other traditional banks reject. So we go into that in some depth and we talk about how they're able to physically do it as far as partnering with a bank, we talk about the regulatory environment, and what Marla would like to see as far as improvements there and we talk about the challenges that she is facing in growing this company. It was a fascinating interview, I hope you enjoy the show!

Welcome to the podcast, Marla.

Marla Blow: Thank you, Peter, a pleasure to be here, very excited.

Peter: Okay, so let's get started. You've had quite an interesting career, it seems, to date. Why don't you get started by giving the listeners a little bit of background about yourself.

Marla: Sure, so I spent about eight years at Capital One in the credit card business where I had the opportunity to move around the organization and work in subprime account acquisitions; I worked in credit risk management for the North America card portfolio; I spent some time in corporate development working on large scale transactions at the organizational level overall, got to see the business from a variety of angles and found myself really enjoying being in consumer finance because it marries the understanding of how humans make decisions and the psychology behind financial services.

And then also with data, and the ability to observe what people are actually doing as presented with the actual data that they generate by their usage of the product. So it was one of those opportunities where the industry itself was just a great fit for two of the things I'm really interested in which is human psychology as well as kind of financial services and information. Over the course of that experience, I got to know quite a few people around the organization moving around Capital One as much as I did and that led to me getting an invitation from one of my former Capital One colleagues to join in implementing and setting up the Consumer Financial Protection Bureau.

So in very early 2011, I left Capital One and had the quite unusual opportunity to start a federal government agency from scratch with a small group of people and I ended up building a division within the Consumer Financial Protection Bureau called The Markets Teams. Markets Teams were designed to bring into the bureau expertise among people who had actually worked in the arenas that ultimately the CFPB was going to regulate and govern. I ultimately then took responsibility for the regulatory outlook and policy for the credit card business across the United States along with a few other transactional areas like pre-paid cards and mobile payments and any transactional device that consumers might have at their disposal.

Peter: Okay, and so then we can segue now into FS Card because it sounds like it's kind of where you're leading. So tell us about the founding story of your company and why you decided to start this business.

Marla: Absolutely, so one of the ways that I ultimately came around to this is in my role at the CFPB, one of my big responsibilities was to go out and be the liaison between the Bureau and management teams and organizations in the credit card industry. Over and over again, I heard from folks that because of the CFPB, because of changes in the regulatory landscape, because of changes in capital requirements, banks were pulling back from this deep subprime consumer.

Hearing that story over and over again it became immediately clear that this means this customer is not being served or at least not being served by this traditional product that used to be fairly available and likely that need for credit hasn't gone away. In fact, it's probably being met by something that's a lot more difficult to manage like expensive alternatives, payday loans, pawn shops, auto, title, other kinds of relatively expensive forms of credit.

I thought somebody should fix that, right, in the way that we often say somebody should do something about that. After saying it enough times, it sort of occurred to me that I could do something about that. I could find a way to partner with a bank and to get into market a traditional, unsecured Mastercard branded regular way credit product, exactly like the kind that Capital One used to do in years past. But Capital One and lots of other entities were facing all those same headwinds that they identified and over time, Capital One has obviously grown now into being a large major bank in the United States.

That means some of the sensitivities about serving customers that are ultimately high risk were now less palatable to that organization. So that's exactly what I did, I went out and found a few seed investors, very early stage, left the CFPB in January of 2014. I like to say that I took an entire weekend off (Peter laughs) and started FS Card on a Monday in January 2014 and went out to find a bank partner, to find a servicing agreement to get us ready to be able to issue this traditional product into the market. And the really important thing to know about this and one of the things that makes it so hard to start a credit card company is you have to build all the infrastructure before we could ever issue card number one.

Peter: Right.

Marla: There's no equivalent of like a minimum viable product or just get something out there. We have to be able to make sure that we can authorize all the transactions, that statements are going to go out, that phones are going to get answered, that transactions are going to be screened for fraud, that we can manage disputes and any kind of challenges that consumers may have as they transact, that we can collect the payments and manage the lockbox; all of those pieces have to be set up upfront.

It ended up taking us about a year and a half and we spent a couple of million dollars, almost $2 million, in being able to just get started with this idea. So that's one of the big barriers to entry and one that I think I anticipated, but I just didn't know exactly sort of viscerally what it was going to feel like to have to invest that heavily and work that hard just to get started with what we wanted to do. And so ultimately, in late 2015, got the first cards out into market which was a fantastic moment for us.

Peter: I'm sure, I'm sure that was. It's interesting because you just don't see many people starting credit card companies, it's just not something that is done everyday, but I want to talk about that actual product that you launched at the end of 2015. Can you explain what your core product is and how it works?

Marla: Absolutely, yeah, so one of the things we offer is a product called the Build Card. The idea is to create access for customers that have been left on the sidelines here and really about creating parity, creating a prime like experience for an underserved kind of subprime consumer. And I should add, subprime is industry jargon...you can imagine that there are not very many people wandering around in the world referring to themselves as subprime (Peter laughs). It doesn't necessarily roll right off the tongue, but for us what I wanted is to enable this population to be able to meet their day-to-day liquidity needs in as flexible and convenient and appropriately priced a way as millions and millions and millions of people get the luxury of taking for granted all the time.

And so we brought a traditional Mastercard branded product called the Build Card to a customer that really was facing scarcity of this kind of credit. For us that was informed by lots of investment in technology, in data analytics, in big data, machine learning, all the tools and kind of buzz words that were very popular and have been in and out of vogue here, but for us this is really about enabling the underpinnings and taking advantage of the way that all of that can be done so much more efficiently now.

With our, at the time, skeleton crew of five or six people and with our partners, we were able to get off the ground a product with a fairly sophisticated underwriting engine, with a significant investment in the technology side of things and with the ability to communicate much more efficiently because of building our own chatbot and being able to communicate in real time, be able to message and nudge and remind people, not just through their statements showing up in the mail, but actually in real time be able to say...hey, your payment is due in a day, your payment is due today, hey your payment was due yesterday, please contact us. All of that ability to reach people is game changing on being able to drive positive credit behavior which is really what we want for this customer.

Peter: So I want to go back with the card, how are you able to offer this credit card where others...these are people, I presume for the most part, are going to be rejected by Capital One or by Well Fargo or Chase or what have you.

Marla: Right, absolutely, and what we think about here is how do we look for information, look for signs of change in this customer's life. One of the things I'm most excited about is we can use artificial intelligence and data mining in order to identify changes in trajectory. Traditionally, people talk about artificial intelligence being able to identify patterns and identify reasons why patterns might continue. What we get the opportunity to look for is what might cause this pattern to change, what might be the leading indicators of something having happened in this customer's life, in this individual's life that puts them in a position to use credit much more wisely and much more readily.

We bring into the consideration set traditional data sources from the credit bureaus that are always used in decisioning credit applications and we supplement that with incredibly rich data from a host of other sources, including things like alternative credit bureaus that collect data on things like utility bills and alternative products like the payday loans that we're talking about before, places that might have information on cell phone usage, other kinds of credit-oriented products or consistency and stability type products that ultimately are not making their way into the traditional data set and puts us in a position to on the margin make a differentiated decision and offer this customer credit and take that risk. But that said, we certainly haven't identified a way to take out risk.

Peter: Right.

Marla: What we have to be able to do is manage what is ultimately a relatively risky portfolio and manage it well and we have to price for the risk. So we are certainly an order of magnitude cheaper than a payday loan, for example, but in our case an interest rate in the high 20's for this credit card which frankly isn't that different from the average interest rate on a credit card more broadly, which is probably in the low 20's or high teens, is meaningfully different for this customer but we do have to charge the cost of that risk and ultimately to be able to offer this product at the right price for the customer that we're serving. Those are the key things we do.

Peter: Right, I presume you're not giving them a $10,000 limit, I presume. What are the limits that you put on these?

Marla: One of the key places we decided to start is to look for an opportunity to solve the credit problem that this kind of customer might otherwise have solved with a payday loan.

Peter: Right.

Marla: The average payday loan in this country is about $350 so what we are doing is making sure that this customer has at least $350 to solve their problem and in our case we start with a $500 credit line. That $500 credit line kind of scratches that itch, is the right level for us to manage the initial upfront risk, give them a little bit of flexibility and cushion above that $350 solution that they were looking for previously and ultimately though is large enough that it matters and lets the person accomplish something on a day-to-day basis, but small enough that we aren't ending up burning through money too quickly on losses on the size of the line.

Peter: Right, that makes sense. This is a regular credit card like I see it here on your website you've got a picture of a Build Card, it's a Mastercard. It's not a pre-paid card, this is a true credit card with no security backing it, right?

Marla: And the fact that you ask exactly those questions is exactly why we're doing it because that is 100% correct. We offer exactly the same kind of card that I walk around with and that prime folks probably have four of in their wallets on a day-to-day basis. You don't have to put down a deposit, there's no security associated with it, there is nothing that makes it unusual from what you would expect a traditional credit card experience to be.

And that was one of the important value propositions and is an important component of the mission of FS Card is to bring that kind of inclusion to this customer that can see people walking around everyday using cards and true a lot of people can't necessarily always discern the difference between a pre-paid card and a traditional credit card, but if you're the user you'd absolutely know the difference and that's what we wanted to do was create traditional credit card availability.

Peter: Okay, so can you give us a sense of...like give a bit of a profile of who the customer is, what's their financial situation, are they sort of up and coming or...they obviously can't go and get a prime credit card, I imagine, so what is the typical profile?

Marla: For us, we emphasize serving the customer that has, in general, had some kind of credit experience. So we find that we often are not serving people who never had credit before, they may have had credit in the past, had problems managing it and now find themselves unable to regain a toehold in the mainstream; might be people who, for some reason or another, have volatility in their lives, maybe they do seasonal work, maybe they work hourly and their hours can rise and fall, they find themselves needing ways to bridge ups and downs.

Also obviously, there's the occasional kind of hiccup in the expense side of the equation, a car repair, a medical expense. Those are the places where this customer ultimately can really make use of this card for kind of day-to-day liquidity. You get to the 27th of the month, you're not getting paid until the 30th and you need to put something on the card; that's exactly what we want people to do.

Peter: Right.

Marla: So what we focus on is encouraging this customer to maintain some availability on the card. We try to get people who are not going to take it and go out and max the card out and then be right back to having no access to credit again. So a lot of our communication strategy, a lot of our use of our chatbot which we call TextMate here internally is designed to drive payments in excess of the minimum to create open to buy and leave some space on the card. That's a very important component.

Peter: So are you educating these customers with regular financial education or how are you driving that behavior?

Marla: We're adding the financial, the typical kind of financial education components in the form of modules and online kind of experiences that can help this customer, but from our perspective a lot of times the idea that we are going to be in a position to tell someone the financial equivalent of you should eat right and exercise...

Peter: (laughs) Right.

Marla: ...is kind of, you know, people get it, right...you should have a budget, you should live below your means, etc. Those shoulds are fairly well established and so what we look for is an opportunity to communicate information that matters. If you make your payment on time, your credit score will improve and try to drive some metrics around that or congratulations, you've taken a step towards driving yourself to a better credit position.

Ways that we can encourage and reward that quality behavior that ultimately leads to moving up the financial scale and what we'd like to do is then grow with that customer giving them better access to credit, larger line size; we do give credit line increases for customers that make their payments on time. All of those dimensions are key components of ultimately, in my view, using behavioral economics and some of the latest thinking about what information is meaningful in a population that has scarcity and where they're having to make tradeoffs all of the time.

So what we really focus on is communicating, using the phone which is the device that is around us all the time and bringing that data to bear on what we communicate and getting that to be the change in behavior in addition to the financial education piece that we're adding to the mix here very soon.

Peter: So how do you go about getting the word out and how are you acquiring these customers?

Marla: We do a ton of pre-screen work because from our perspective if we put up a portal and say, come one, come all ye that have challenges with credit, we'll got lots and lots and lots of people that want to take us up on that and we will end up creating bad experiences for lots of people because, as I mentioned earlier, we have to get the credit piece right. This is unsecured and we absorb the losses so if we get this wrong, we won't be around.

So what we encourage is inviting the people who have demonstrated that change in trajectory that I was talking about earlier where we see something in their lives that's just, they're ready for another bite at the apple of traditional credit and that is a critical consideration for us.

We send out lots of direct mail, mail that prime and super-prime people think of as junk mail, that might be cluttering up your house or clogging the mailbox at your home. But for the customers that we serve those kind of traditional offers are still relatively rare and so we've been able to attack a market via good old fashioned kind of direct mail informed by all the latest cutting edge techniques and we drive them to our website to go and put it in their solicitation number and apply online and apply on their phones and through the app, etc. and sign up for the TextMate platform, but a lot of the work is still that pre-screened direct mail invitation that comes in the mail.

Peter: Right, we're all very familiar with that. That's been the bread and butter of the online lending space since inception really.

Marla: It is, it's very much alive and well and there's a lot of interesting opportunities for digital and online and we're working on building that out and we're really excited about some of the prospects for doing the equivalent of pre-screen in an online world, but while we continue to perfect that and make that kind of investment, we send out the mail.

Peter: Right, right. So then can you just share a little bit of...I'm just curious, you issued your first card in 2015 and this is not a term loan. It is something that you can judge month by month how you're doing. Obviously this is a high risk population or higher risk population than a prime card, but can you give us a sense of where defaults are at and how they're trending?

Marla: Ultimately for us, what we want is to enable this customer to move up the credit spectrum and the way we measure are we succeeding in what we set out to do is how many of these customers are receiving things like credit line increases, how many of them are still around after two years. Our oldest accounts are a little over two years old now and happy to report we're able to get a quarter to a third of those customers of ours through a credit line increase and get them using ever greater access to credit.

We find that people are using the cards exactly the way that we intend meaning gas, groceries, dining out, day-to-day spend. We don't see any of the use cases that we would be concerned about like people trying to take cash advances or other kinds of short term opportunities. We really want people to be able to meet their day-to-day living needs with this product and that's working. We still have some of those, you know, that very small pilot set of accounts that we booked in 2015, we still have a reasonable percentage of those folks around and using the card and have larger lines and have continued to be very active and engaged with the product and that is for us, ultimately, the real measure of success and being able to get those folks to better credit and improve their credit score.

Peter: Right, right. I presume you are sending data to the credit bureaus, that's how they're going to get their credit score improved?

Marla: That's right. With appropriate usage, we report all the usage to the credit bureaus and so if you make your payments on time, you pay in excess of the minimum demonstrating open to buy, etc. those things will naturally get factored into your credit score and lead to improvements on the credit bureau that will be visible and likely lead to offers from others in the credit space so it's all about creating that on-ramp. Obviously, the opportunity for us is to grow with that customer and keep them around, but they move and get even better offers. We completely understand and that's part of the journey, for sure.

Peter: Right, so you're not a bank, I presume, right, so you don't have a banking license, I mean, how are you issuing these cards?

Marla: We have a bank partner and in our case what the bank partner does is importantly is able to get us...we use their relationships in order to get on the Mastercard rails to be able to issue the card and the bank ultimately retains ownership of the account over the life of the card itself. We though are the holders of the outstandings and the obligations on the card or the large majority of the outstanding.

Peter: So what's your business model, I mean, how do you make money?

Marla: In a lot of respects, we are exactly like any other credit card company. We do charge interest for people to use these cards, we earn interchange fees when people swipe the card and use it at the point of sale. We do charge an annual fee for people to have this card and be a part of this product. Those are our very direct kind of per account drivers of the profitability in the business and then what we have to be able to do well is continue to deploy technology, be able to continue to make some investments in training, artificial intelligence, to put us in a position to bring that loss level down.

And if we can bring the loss level down, all of that is revenue for us, the customers that stay around longer and then ultimately to make sure that we can service as efficiently as possible and bring the cost of servicing down as well.

Peter: Right.

Marla: So it's a very direct kind of consumer driven financial service that we offer.

Peter: Right, right. So I want to switch gears just for a second. I'd like you to go back and put on your CFPB hat. I'm curious to know, obviously the CFPB has a lot of…it's in flux it seems right now, there's a lot of activity there, but putting all of that aside, I'm curious, from your point of view from a regulatory perspective....everyone should have more access to responsible credit, but what are the things that you think, from a regulatory perspective, what could regulators be doing to help people like your customers get better access to financial services?

Marla: Fundamentally, serving this kind of customer with lending products, with traditional lending products is hard and one of the most promising dimensions of being able to crack this open, and the place where we continue to make big investments, is technology and data. There are still really big open questions about the use of data. We all generate data every day by what we click on, by what we post in social media, by the times of day that we do things online; all of that information is out there and in many ways that can be predictive of credit quality, but it is very unclear whether that data can be used or I should say given the state of the regulatory environment it is very risky to use that data to make a credit decision.

That means that for people who do not show up in the credit bureaus, who might not have had credit previously and are trying to get their very first product, enabling the use of data and putting financial services providers in the position to be confident and sure footed in offering products that are based on that data is a way of opening up this market in ways that I think would be profound for a lot of these folks that find themselves credit invisible or in other kinds of categories that make it hard.

Peter: Yeah, that makes sense to me. So then we're almost out of time, but there's a couple of more things I'd like you to touch on. I've had a few people on in recent months in sort of more of the subprime and near prime space, but the majority of companies out there seem like they don't want to focus on this space. What more should fintech companies be doing to help these underserved potential borrowers?

Marla: This is one of those things that is absolutely near and dear to my heart. I really would welcome more people to try to solve problems for this part of the market rather than going after the already incredibly well served and make them even better served people (Peter laughs), and make it even more convenient and you can now get a mortgage in 5 seconds rather than 10 seconds or whatever it is, that's obviously an exaggeration.

But if we could really focus on the variety of needs and thinking about not just the availability of disposable funds from the customers but thinking about what the needs are, I think people would see, even in the fintech arena, that there is meaningful business to be done in this underserved population and to think differently about how you can create a service that the customer is realizing value and is willing to pay for that value, not that they're not willing to pay; it's just that there has to be thought around exactly how you do it and how you do it in light of the regulatory construct.

There's plenty of opportunities to bring services that are still missing from parts of this population, there's still access questions about getting bank accounts, still access questions about whether or not people are getting quality auto loans and other kinds of products along those lines. So finding that kind of wherewithal to make the investment in using additional data, in solving problems for a population that doesn't necessarily immediately stand out as the high volume, high impact, large scale dollars right out of the gate more than make up for it in numbers and I think that there's a ton of opportunity to be plumbed right there.

Peter: Right, right, I completely agree. So, then the last question, so what would you say are the biggest challenges now for you? What do you need to overcome to really get your business at a large scale?

Marla: For us, this is now about building a brand. One of the things I'm most excited about is thinking through the messaging, the communication, the going broad with our message and putting us in a position to be able to get this card into more and more hands, even if we haven't done all the pre-screen work that I talked about earlier. So we do want this product to become something where we drive demand through larger messaging as well as the targeted product offers to individuals that we pre-identify and so getting us out in front of broader and broader audiences and being able to field that inflow is a place where we can springboard to truly that next level.

We've really nailed down many of the components of the business model, understand the credit, understand the need and these customers' patterns and for us now it's putting that in a much larger arena and being able to continue to maintain the same kinds of metrics and the same kinds of success on finding people that get larger lines and finding people who stay around and really benefit as a win-win for both us and the customer. So that is the opportunity, is that messaging, so stay tuned for the Build Card commercial during the Super Bowl and we'll go from there.

Peter: (laughs) I will stay tuned to that.

Marla: I didn't say which Super Bowl, could be this coming one, could be 2020.

Peter: I'll be looking out for it. Okay, thank you so much for coming on the show today, Marla.

Marla: I truly enjoyed it, Peter, thank you very much.

Peter: Okay, see you.

Marla: Bye.

Peter: I certainly applaud Marla and what she's trying to do and I think it's really...I agree that there's not enough happening at this end of the market, there's not enough competition, there's not enough entrepreneurial activity. As we said the prime segment is well served, I think that this segment, with the explosion of machine learning and data techniques that are more predictive, I feel like we're at the cusp of being able to accurately underwrite much wider segments of the population than we've ever been able to before.

We're not quite there yet, as Marla pointed out from a regulatory perspective, we probably need some help to get that done. I think it's exciting that a lot of the things that are happening in the developing world where they're able to really do things in a very creative way. We can take some of those learnings and apply them to the developed world and to help those that are underserved in this part of the world.

Anyway on that note, I will sign off. I very much appreciate your listening and I'll catch you next time. Bye.

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